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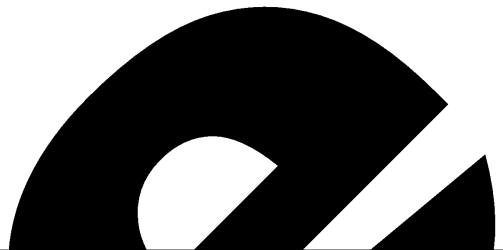

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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Changes In The World Tanker Market And Their Near Term Effects

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
September 1971

INTELLIGENCE MEMORANDUM

CHANGES IN THE WORLD TANKER MARKET AND THEIR NEAR TERM EFFECTS

Introduction

1. The threat of interruption of Libyan petroleum output or at least reduced availability in the last half of 1970 and the shutdown in May 1970 of the Trans-Arabian pipeline (Tapline) that carries part of Saudi Arabian oil to the eastern Mediterranean produced anxiety in the industry about the capability of the world tanker fleet to meet the growing oil demand in Western Europe and Japan. This anxiety was reflected in a spiralling increase in transport rates. The initial settlement of Libyan demands in September 1970 led to some moderation in this spiral, and with the restoration of Tapline and the general settlements in early 1971 these rates have since declined sharply. An unusual shift in international oil trade movements from short-haul to long-haul suppliers has followed. This memorandum reviews the causes and effects of the gyrations in the tanker market and speculates on certain near-term implications.

Discussion

The Changing Tanker Market

2. The world tanker market has swung in recent months from an extremely tight to a veritable surplus condition. By mid-1971, "spot," or single-voyage, tanker rates – the most volatile index of tanker availability and demand – had declined about 75% from the historic peak reached in October 1970. These single-voyage charters are normally employed in the movement of marginal volumes of oil and involve about 10% to 15% of the world tanker fleet; most of the remainder of the fleet is either owned or leased by oil companies or on long-term charter. Rates for long-term charters are more stable but generally follow the trend of the spot charter market. Spot and average charter rates for all tankers during the period

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

October 1969 through July 1971 for the Persian Gulf to Western Europe route are illustrated in Figure 1.

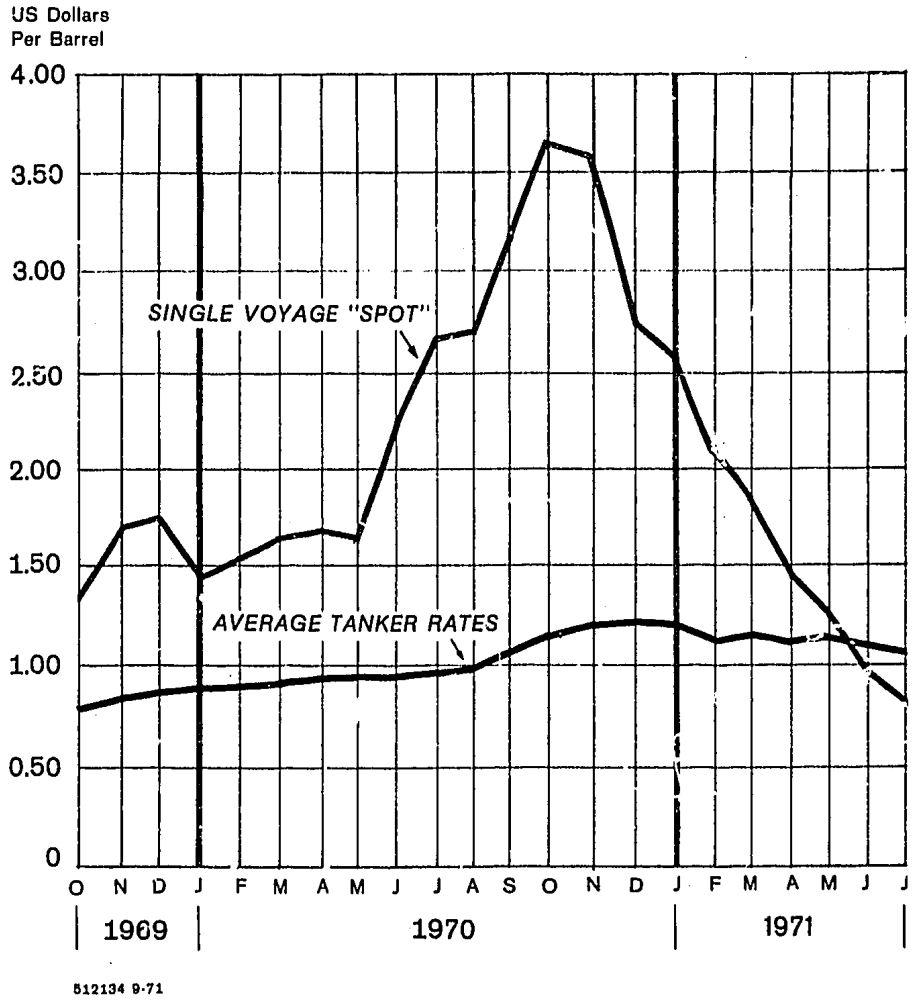
3. Spot charter rates began a sharp rise in mid-1970 following the reduction in the volume of short-haul oil available in the Mediterranean area. Replacement for this oil in the markets in Western Europe had to come from the Persian Gulf, and, with the continued closure of the Suez Canal, additional tanker capacity was required to make the long haul around South Africa to those same markets. This increased demand for tankers in the last half of 1970 was aggravated by the seasonal demand for oil both to replenish stocks in Western Europe that had been drawn down during the severe winter of 1969-70 and to build up stocks for the new winter season.

4. High freight rates continued into the new year, but a sharp decline had begun in December and by mid-1971 these rates had dipped to their lowest levels since the Six-Day War. Tanker rates for a single voyage from the Persian Gulf to Rotterdam were about $2.50 per barrel in January 1971; rates had declined to about $1.00 per barrel in June. A combination of factors contributed to the decline: (a) Tapline reopened in January, and (b) the demand that traditionally occurs in the spring was dampened when it became evident that late winter stock levels would be abnormally high as a result of earlier additions to stocks for fear of further production cutbacks in Libya and the lower-than-expected consumption of petroleum during the mild winter in Western Europe. The decline in rates might have been even more pronounced had not scare buying emerged with the threat of a production shutdown during the period of contentious negotiations in early 1971 between the members of the Organization of Petroleum Exporting Countries (OPEC) and the international oil companies over increased revenues.

5. Increased availability of tankers has also contributed to the weakening charter market. The world tanker fleet has increased by about 15% since mid-1970. Moreover, combination carriers -- ships which can carry either ore, oil, or other bulk cargo such as grain -- also have had a considerable influence on the tanker market. Combined carriers generally move between oil and non-oil trade, whichever market is more attractive. In recent months, some 85% of the combination fleet has been working in the oil trade because of depressed rates in the dry cargo market. Although the tanker market may strengthen somewhat in the fall, there appears to be enough tankers currently available for charter to keep rates at reasonable levels this winter, barring some prolonged interruption to the pipelines between the Persian Gulf states and the eastern Mediterranean. Temporary interruptions of the pipelines, of the type caused by "sabotage" of Tapline on 8 September 1971, are not likely to affect the tanker market.

Figure 1

TANKER RATES
Persian Gulf to Rotterdam



Changes in the Oil Supply and Demand Pattern in Western Europe

6. Oil stocks in Western Europe normally are drawn down during the winter season and are replenished during the summer, resulting in a fairly constant flow of oil imports. Figure 2 depicts the seasonal consumption and import pattern during 1967-70. There has been a slackening in the growth of oil deliveries in recent months following heavy imports during late 1970 and early 1971. The upward trend in imports is expected to resume when the present tight storage conditions, caused by high stock levels, eases. Additional storage capacity is planned or under construction in most West European countries to implement new stock level policies. European members of the Organization for Economic Cooperation and Development (OECD) have resolved to develop stock levels sufficient for at least 90 days' consumption. Previously, OECD European members had a stock level goal of 60 days.

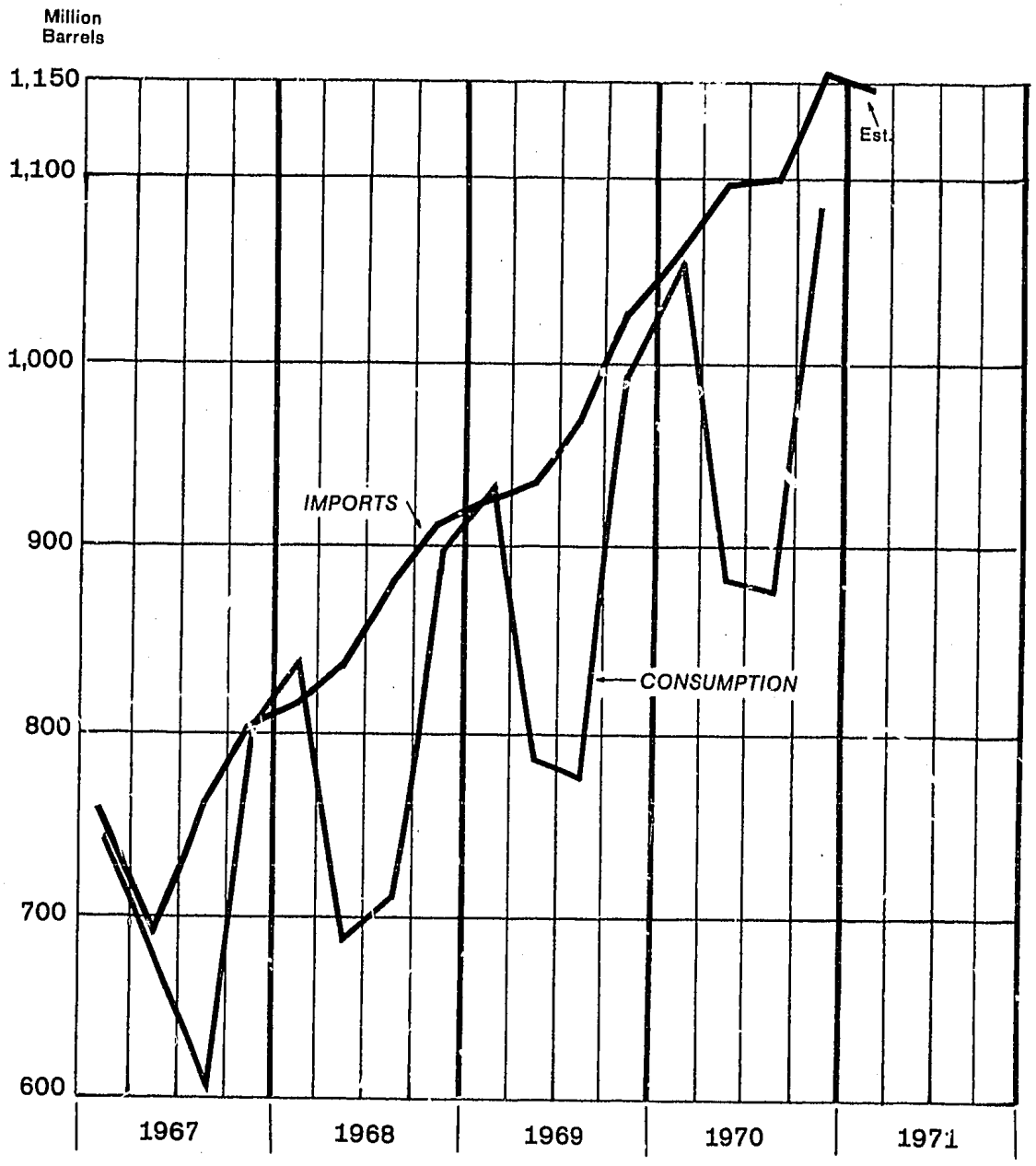
7. The favorable stock position in Western Europe and the declining tanker charter rates have been reflected in a shift in inter-regional exports of oil. Oil production in the Persian Gulf increased by more than 20% in the first half of 1971 compared with the same period last year, while Mediterranean output declined about 10%. Production data for Persian Gulf and Mediterranean sources for January-June 1970 and 1971 are shown in the table.

8. The decline in oil supplies at sources in the Mediterranean was caused by reduction in Libyan production and by the interruption of Algerian production by that government's partial nationalization of French oil company assets. Oil produced in Libya and Algeria has a significantly higher tax-paid cost to the oil companies to reflect its geographical advantage over Persian Gulf oil to the markets in Western Europe. Although this cost has a freight adjustment factor, Libyan production in June and July had dropped even below the limits set by the government, reflecting in part the lower delivered costs to Europe of Persian Gulf crude oils. Similarly, because of the decline in tanker rates and increased pipeline transit fees, Iraqi and Saudi Arabian crude oils delivered to Western Europe by way of the Cape of Good Hope now have a competitive advantage over similar crude oils delivered by way of the eastern Mediterranean pipelines termini. As a result, Tapline operated at less than 50% capacity in June and July; the Iraqi Petroleum Company (IPC) pipeline operated at only about 60% of capacity in July.

9. The total volume of oil available at all Mediterranean sources in July was about 4 million barrels per day, compared with a peak of about 6 million in April of 1970. This decline is the more remarkable when considered in the light of the anxiety expressed in world oil circles in

Figure 2

OECD EUROPE
Crude Oil Imports and Petroleum Product Consumption
(excluding bunkers)



Middle East/North Africa Crude Oil Production by Persian Gulf and Mediterranean Outlets

	Thousand Barrels per Day		
	Jan - Jun		
	1970	1971	Percentage Change
Total	*18,244*	*20,212*	*10.9*
Persian Gulf outlets	11,862	14,512	22.3
Iran	3,741	4,520	20.8
Saudi Arabia	2,297	4,251	28.9
Kuwait	2,921	3,244	11.1
Iraq	438	678	54.8
Abu Dhabi	610	905	48.4
Bahrain	77	76	-1.3
Dubai	70	125	78.6
Oman	345	292	-15.4
Qatar	363	421	16.0
Mediterranean outlets	6,362	5,700	-10.4
Libya	3,548	2,962	-16.5
Algeria	920	750	-18.5
Iraq a/	1,072	1,082	0.9
Saudi Arabia b/	335	380	13.4
Syria	80	100	25.0
Tunisia	80	86	7.5
Egypt c/	327	340	4.0

a. Moved through the IPC Pipeline system.
b. Moved through Tapline.
c. Egyptian oil for export is available only in the Gulf of Suez.

mid-1970 about oil supply and the spectacular increase in spot charter rates when Libyan production cutbacks and the shutdown of Tapline reduced Mediterranean supplies by about 1 million barrels per day.

Decline in Prices of Petroleum Products

10. By mid-1971 there had been a weakening of prices of petroleum products, particularly residual fuel oil, in Western Europe. Product prices had been increased earlier in the year to reflect the higher tax-paid cost of crude oil resulting from the OPEC settlement. The combination of lower tanker rates, high stock levels, and increased imports of crude oil from the Persian Gulf at the expense of North African sources has contributed to the decline in product prices. Persian Gulf crude oils yield a greater percentage of residual fuel oil than those from North Africa, and marketers in Western Europe with abnormal inventories have been forced to reduce fuel oil prices to keep their supplies moving. Similarly, the high-sulfur fuel oils from Gulf crudes are sold at lower prices than the low-sulfur fuel oils from North African crudes.

Conclusions

11. The current availability of tankers appears adequate to assure Western Europe and Japan of favorable oil supply conditions as the heavy winter consumption period approaches. Spot tanker costs are not expected to increase significantly from their present levels in the near term. The average cost of moving oil, however, will remain higher than it was a year ago. The Persian Gulf oil-producing states have clearly gained from the improved tanker situation at the expense of Mediterranean oil producers and the pipeline (Tapline and IPC) transit countries. Libya, Algeria, Syria, Jordan, and Lebanon as well as Iraq probably will receive somewhat less revenue in 1971 than expected. The increasing demand for low-sulfur crude oil from Libya and Algeria probably will militate against a substantial reduction of North African oil production. The transit countries may react to the loss of pipeline revenues by harassing the owners through threats of closing the systems, which would have serious repercussions in the tanker market.

12. In general, current prices for crude petroleum and its products are expected to remain firm. There may be further weakening of some petroleum product prices in Western Europe and even crude oil prices in the Mediterranean if, as seems likely, tanker rates remain at or near current levels. Under terms of the OPEC settlement, a freight adjustment factor to reflect fluctuations in tanker freight rates is to be applied to Mediterranean crude oils each calendar quarter.